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| **Chapter 13 - Price Element of the Marketing Mix** | | |
|  | | **Learning Objectives:** |
|  | | *Upon completion of this unit the learner should be able to:*   1. Explain the meaning and importance of price. 2. Identify the elements that make up a price. 3. Recognize the constraints on a firm's pricing. 4. Explain the role of costs in pricing decisions. 5. Explain what a demand curve is and how it affects a firm's total and marginal revenue. Calculate a break-even point for various combinations of price, fixed cost, and unit variable cost. 6. Review pricing policies and objectives. 7. Understand how to establish the initial "approximate price level" using demand-oriented, cost-oriented, profit-oriented, and competition-oriented approaches 8. Identify the major factors considered in deriving a final list or quoted price. 9. Prepare basic financial analysis useful in evaluating alternative prices and arriving at the final sales price. 10. Describe the principal laws and regulations affecting pricing practices. |
|  | | **Overview of this Unit** |
|  | | This unit examines the elements of the price element in more detail including how to set prices and how to calculate the break-even point. |
| **Price and Profit** | |
| Price is the money or other consideration exchanged for ownership or use of a good or service.  **Price and Value**   |  |  | | --- | --- | | Dollar Sign | ***Price*** is a fixed term. ***Value*** is a relative term that is measured by the consumer.***Value*** is the ratio of perceived benefits offered to price charged:  **VALUE = Perceived benefits                      Price** |   **Price is made up of...**   |  |  | | --- | --- | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/bullet3.gif | the Sticker (list) price **less** any: | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/bullet3.gif | Discounts offered (sales, mark-downs, volume) **less** any: | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/bullet3.gif | Allowances offered (trade-in allowances, case allowances) **plus** any applicable: | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/bullet3.gif | Taxes |   **Profit**  Total Revenue (Price x Quantity) less Total Cost (Fixed Costs + Variable Costs) | |

**MR2100 Marketing II (Winter 2009) - Unit 4.  Price Element of the Marketing Mix -    The Steps Involved in Setting a Price**

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| **The Steps Involved in Setting a Price** |
| |  |  | | --- | --- | | Step 1 | Identify pricing constraints and objectives. | | Step 2 | Estimate demand and estimate revenue. | | Step 3 | Determine cost-volume and profit relationships. | | Step 4 | Select an approximate price level. | | Step 5 | Select a list price. | | Step 6 | Make special adjustments to quoted price. |   Each step will now be explained in detail. |

**MR2100 Marketing II (Winter 2009) - Unit 4.  Price Element of the Marketing Mix -    Step 1: Identify Constraints and Objectives**

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| **Step 1: Identify Constraints and Objectives** |
| ***Constraints*** are practical limits under which a company must set its price range for a product.  *Constraints* include:   |  |  | | --- | --- | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/1.gif | Demand for the actual product, its class of product or the demand for the Brand name. | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/2.gif | Newness of the product - where it is in the life cycle. | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/3.gif | A single product limits the range of prices that can be charged, whereas a line of products can be offered at different prices depending on the model. | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/4.gif | The cost of making and marketing the product. | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/5.gif | The costs involved in changing the prices once they are set. | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/6.gif | The type of competitive market that exists.  Little competition means prices can be set by the seller whereas heavy competition means that the market sets the prices and as a result prices will tend to go down. | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/7.gif | What other similar products sell for limits the range of price that can be charge. |   The constraints establish the upper and lower bound for a price that can be charged.  Where and how a product is priced within that upper and lower bound depends on the ***objectives*** of the organization  **Objectives**  The various objectives that an organization has in order to set its prices depend on several factors:   |  |  | | --- | --- | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/diamond.gif | Are they wanting to maximize profit? | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/diamond.gif | Are they wanting to maximize sales revenue? | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/diamond.gif | Are they trying to maximize market share? | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/diamond.gif | Are they trying to sell a lot of product? | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/diamond.gif | Are they trying to maximize consumer value? | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/diamond.gif | Are they trying to be socially responsible? | | http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/diamond.gif | or, finally Are they just trying to survive? | |

**MR2100 Marketing II (Winter 2009) - Unit 4.  Price Element of the Marketing Mix -    Step 2: Estimate Demand and Project Revenue**

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| **Step 2: Estimate Demand and Project Revenue** |
| The ***Demand*** for a product is a function of two major types of things:   |  |  | | --- | --- | | One | The price of the product - usually the higher the price the lower the demand. | | Two | Factors other than price, such as consumer tastes, consumer income or the availability and price of other similar or substitutable products. |   A *Demand Schedule* and a *Demand Curve* reflecting different price levels:   |  |  | | --- | --- | | **Price** | **Quantity Demanded** | | 5 | 1000 | | 4 | 2000 | | 3 | 3000 | | 2 | 4000 | | 1 | 5000 |   http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/demand.jpg    A *Demand Schedule* and a *Demand Curve* reflecting a shift in the demand curve in quantity demanded because of non-price changes.  Assume that the product becomes "trendy".  Relative quantity demanded at any given price point goes up:   |  |  |  | | --- | --- | --- | | **Price** | **Quantity Demanded** | **New Qty Demanded** | | 5 | 1000 | 2000 | | 4 | 2000 | 3000 | | 3 | 3000 | 4000 | | 2 | 4000 | 5000 | | 1 | 5000 | 6000 |   http://d2l.cna.nl.ca/content/W09/MR2100_W09/images/demand2.jpg  **Terms to Know:**   * Total Revenue * Average Revenue * Marginal Revenue * Elasticity of Demand |

**MR2100 Marketing II (Winter 2009) - Unit 4.  Price Element of the Marketing Mix -    Step 3: Determine a Cost-Profit, Cost-Volume Relationship**

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| **Step 3 - Determine a Cost-Profit, Cost-Volume Relationship** |
| **Marginal Analysis**  One way an organization can determine whether it is maximizing its potential profit is to calculate its marginal costs and marginal revenues from one level of output to the next.   |  |  | | --- | --- | | Think About It | When marginal costs equal marginal revenue *(MR=MC)* stop producing/selling any more.  ***Why****?*: it costs as much to make that extra unit as the extra revenue selling that unit will bring in. |   **Break-Even Analysis**  This determines the level of production/sales required in order for a company to stop losing money, break-even and start making money.  To calculate the break even point (in units), you need:   * Total Fixed Costs * Unit Variable Costs * Selling Price per Unit   ***Break Even Point =*** *Fixed Costs*                                                           *Selling Price per Unit - Unit Variable Cost*  Chart |

**MR2100 Marketing II (Winter 2009) - Unit 5.  Price Element of the Marketing Mix - Continued -    Step 4 - Selecting an Approximate Price Level**

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| **Step 4 - Selecting an Approximate Price Level** |
| There are four basic methods used to set an approximate price level.   |  |  | | --- | --- | | One | **Demand-Based Methods**  The price that is picked is set based on the projected demand for the product.  Specific strategies include:   * *Skimming pricing* - High price - low volume * *Penetration pricing* - Lower price - price high volume * *Prestige pricing* - Similar to skimming with snob appeal * *Price Lining* - Offering different models with different prices * *Odd-eve pricing* - Setting prices with odd number e.g. $499.99 sounds and feels better than %500.00 * *Demand Backward* -   + predict sales,   + set Total Revenue target,   + take total revenue / sales in units = price * *Bundle pricing* - Offering a bundle of complementary products for a single package price - vacation packages * *Value-based pricing* - Increase benefits offered for a same or lower price. | | Two | **Cost-Based Methods**  The price is set based on the approximate cost of bringing the product to market.   * *Mark-up pricing* - The cost of the product is the basis for which the price calculation is based.   + Standard mark-up and Cost-plus pricing add a fixed percentage or fixed amount to the cost to arrive at a price * *Experience curve pricing* - As you get better at making products, the time and cost to make each one is reduced - therefore the price can be reduced. | | Three | **Profit-Based Methods**  A price setter may choose to balance both revenue and costs to set price using profit-oriented appraoches.   * *Target profit pricing* - This involves setting an annual target of a specific dollar volume of profit and using a calculation to establish a price. * *Target Return on Sales pricing* - This method sets prices that will give the firm a profit that is a specified percentage of sales. * *Target Return on Investment pricing* - A Return on Investment (ROI) percentage is chosen and prices are set to achieve this ROI. | | Four | **Competition-Based Methods**  Price is set based on what the competition and the market is doing.   * *Customary pricing* - Charge a price that is the "usual" price in the industry * *Above-Below Market pricing* - Charge a price that differs from the industry. * *Loss-Leader pricing* - Sell a promoted item at a loss or low price with the intent to attract customers to buy this product and in the process they will buy other regular priced items. * *Sealed Bid pricing* - Same as a "Tender" - Suppliers are invited to bid to supply specified product(s) and the lowest bid price wins the deal. | |

**MR2100 Marketing II (Winter 2009) - Unit 5.  Price Element of the Marketing Mix - Continued -    Step 5 - Set a List Price**

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| **Step 5 - Set a List Price** |
| Based on all of the analysis done thus far in the process, a "List" price can be determined.  The list price is a suggested price and may not truly reflect the price charged to all customers.  Companies must decide whether to follow a:   * *One-price policy* - also called *fixed pricing*, is setting one price for all buyers of a product or service * *Flexible-price policy* - also called *dynamic pricing*, involves setting different prices for products and services depending on individual buyers and purchase situations   Customer, company and competitive factors may come into play in determining whether or not a company deviates from its list price.   * *Company factors* - other products in the product line may affect price * *Customer factors* - retailers often set prices on products below the "List" price.  How customers perceive this price differential can make a difference to sales * *Competitive factors* - setting a "list" price must also consider how the competition will perceive the price and how the competition will react to the set price  |  |  | | --- | --- | | Weblinks | For more information on setting prices, review the site listed below:  <http://www.marketingteacher.com/Lessons/lesson_pricing.htm> | |

**MR2100 Marketing II (Winter 2009) - Unit 5.  Price Element of the Marketing Mix - Continued -    Step 6 - Adjustments to the List Price**

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| **Step 6 - Adjustments to the List Price** |
| Once a "list" price is set, manufacturers often make special adjustments to the list or quoted price. The various ways of doing this include:   |  |  | | --- | --- | | ONe | **Discounts**  Reductions in the list price based on some of the following reasons:   * *Quantity* - reductions in unit costs for larger amounts purchased * *Seasonality* - discounts offered before a season starts to encourage dealer purchase, e.g. discount in July on ski doos.Skidoo * *Trade* - also called *functional* discounts, used by manufacturers to reward wholesalers or retailers for the marketing functions they will perform in the future * *Cash* discounts - used to encourage retailers and wholesalers to pay their bills earlier.  A reduction in the bill will be made available if paid before the due date. | | Two | **Allowances**  An effective reduction in the unit price based on some of the following reasons:   * *Trade-in allowance* - a reduction in price if you "trade-in" a similar item. e.g. a reduced price ifSandwich Board you trade in your old car or appliance. * *Promotional allowance* - if retailers or wholesalers undertake certain advertising or marketing promotions on behalf of the manufacturer, the manufacturer can give a promotional allowance, often a cash payment, to promote the product. | | Three | **Geographical Adjustments**  An effective reduction or increase in the unit list price because of your geographical location relative to the supplier.   * *Free-On-Board (FOB) pricing* - They will put it on the truck but you pay for the shipping costsTruck * *Uniform Delivery pricing* - Price is the same wherever you live - the supplier pays the shipping. | |

**MR2100 Marketing II (Winter 2009) - Unit 5.  Price Element of the Marketing Mix - Continued -    Legal Aspects of Setting Prices**

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| **Legal Aspects of Setting Prices** |
| Setting a price can be quite complex. It is made even more difficult by legal and regulatory restrictions.  ***Price***  ***Price Fixing***  Several suppliers colluding to raise prices. Collusion is illegal.  ***Price Discrimination***  Charging one price to one customer and a different price to another customer for no reason.  This is also illegal.  ***Deceptive Pricing***  Falsifying the true price of the item - deceiving the customer is also illegal.  There are various different types:   * *bait & switch* - a firm offers a very low price on a product (the bait) to attract customers but the customer is persuaded to buy another higher-priced item (the switch) using a variety of tricks including not having it in stock * *bargains conditional on other purchases* - the "buy 1- get 1 free" deals.  These deals are only legal if the first item is sold at regular price and not inflated by the offer.  Also substituting lower-quality items on either first or second purchase is considered illegal. * *comparable value comparisons* - offering "retail value $100, our price $85" only works if other stores sell it for the $100 * *Comparisons with suggested prices* - a claim that a price is below a manufacturer's suggested or list price may be deceptive if few or no sales occur at that price in a retailer's market area. * *Former price comparisons* - a retailer may sell a reduced item only if it was sold at regular price for a substantial period of time. |